

**BEFORE THE UNITED STATES DEPARTMENT
OF AGRICULTURE
AGRICULTURAL MARKETING SERVICE**

**In the Matter of
Milk In The Central
Marketing Area**

**:
: Docket Nos.:
: AO-313-A44 et al;
: DA-01-07
:**

Statement Regarding Proposals 1 – 5

**Elvin Hollon
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6248

**November 14, 2001
Kansas City, Missouri**

Statement of Proponents

The proponents of proposals 1 – 6 are Dairy Farmers of America, Inc., Prairie Farms Dairy, Inc. and Swiss Valley Farms Cooperative.

Dairy Farmers of America (DFA) is a member owned Capper Volstead cooperative of 16,905 farms that produce milk in 46 states. DFA pools milk on 10 of the 11 Federal Milk Marketing Orders including the Central Federal Order.

Prairie Farms Dairy, Inc. (PF) is a member owned Capper Volstead cooperative of 800 farms that produce milk in 6 states. PF pools milk on 2 of the 11 Federal Milk Marketing Orders including the Central Federal Order.

Swiss Valley Farms Cooperative (SVFC) is a member owned Capper Volstead cooperative of 1,500 farms that produce milk in four states. SVFC pools milk on 3 of the 11 Federal Milk Marketing Orders including the Central Federal Order.

The proponents are ardent supporters of Federal Milk Marketing Orders and we believe that without them dairy farmers economic livelihood would be much worse. Federal Orders are economically proven marketing tools for dairy farmers. The central issue of this hearing - providing for orderly marketing and economically justifying the appropriate performance qualifications for sharing in the market wide pool proceeds of an Order is the heart of the Federal Order system. If these issues are not addressed properly system wide, Orders will be jeopardized. That would be detrimental to all the members of our group both in their day-to-day dairy farm enterprises and the milk processing investments that they have made.

Summary of Proposals for This Hearing

The proponents have an interest in the proposals being heard at this hearing. These amendments are being requested by producers due to the present day dynamics surrounding the pooling of milk in Federal Milk Marketing Orders. We are the proponents of proposals 1 – 6 and will present testimony and evidence to support them at this hearing.

Proposals 1 – 5 deal with the “open pooling” of large volumes of milk from locations most of which are so distant to the market that we question if they would ever regularly serve the market in any capacity. Milk distant to

the market needs to have additional performance requirements that are workable and consistent system wide with Federal Order policy.

Proposal 7 and 8 also deal with milk from distant locations. Comments on these proposals will be made from individual members of our group and do not reflect any group consensus.

Proposal 6 reflects the position that the use of the lowest prior month's Class price to set the advance payment to producers is no longer a reasonable mechanism.

Proposal 9 deals with producer association issues.

Our witnesses and their submissions are as follows:

Mr. Hollon - Need for the hearing, structure set by Federal Order Reform, submission of and testimony referring to various exhibits and comment on the Market Administrator exhibits and the specifics and the intent of our proposal language;

Mr. Lee - Specific concerns from a cooperative handler with bottling plant operations;

Mr. Hollon - Support for proposal 6, summary of proposals and the need for an emergency decision.

Mr. Hollon will offer testimony on Proposal 7 and comments on Proposal 8 and a modification to proposals 1- 5 separately and not reflective of the groups consensus.

Not Just a Federal Order 32 Issue

With regard to **Proposals 1 – ~~3~~ and 5** we note that the underlying issue is not just a local Order 32 issue. We have concerns identical to those expressed by the other proponents here and in the Pacific Northwest, Western, Mideast and Upper Midwest Federal Orders - that milk from distant areas is pooling on the Order and drawing down the blend price but not serving the market in any regular form. We find this practice detrimental to our members, our customers and the entire Federal Order system. We plan to express that concern in other Federal Order hearings and seek a solution that is consistent and in line with Federal Order principles system wide.

The central issue in each case is the interface between the pricing surface, altered by Federal Order Reform (Reform) and the pooling provisions found in each Order. Those relationships were changed by Reform. The

link between performance and pooling was altered and needs review. Organizations, including DFA and many of the other proponents of these proposals here, have moved quickly to take advantage of these changes in Order rules. Indeed, in the competitive dairy economy if a competitor makes a pooling decision that results in increased funds you must attempt to do the same or face a more difficult competitive position. Individual organizations cannot unilaterally disarm! We think this process of extensive distant market open pooling is inconsistent with Federal Order policy and clearly disparaged in the Reform record. DFA is supporting similar proposals that have been submitted in the proposed Order 124 hearing that reflect this philosophy. DFA and Prairie Farms have already offered proposals, and presented testimony and evidence in the Order 33 hearing consistent with the principles advanced here and DFA has done so in the Order 30 hearing.

Furthermore the proponents attempted to gain some relief from the pressure on the blend price from the pooling of distant milk on Order 32 through a request to the Market Administrator to use his discretionary authority. We asked that to better align performance standards with market reality he reduce the diversion limitations. However, our request was denied primarily because some of the very liberal Order 32 performance provisions, which were included in the Order as a result of Reform, were not subject to "Market Administrator discretion" and thus would circumvent our request. Several of our proposals here today seek to remedy this issue.

Federal Order Reform

The Final Rule published on September 1, 1999 in the Federal Register culminated the Federal Order Reform process. It was a lengthy process but produced needed beneficial results for the industry - which could not have been accomplished without the informal rule making process. Through it the number of Federal Orders were reduced from 31 Orders / marketing areas down to 11. It provided clear rules for what constitutes a market. The pricing provisions were improved, modernized and made more uniform and transparent across the Federal Order system. A more common classification system and standardization of the provisions common to all Orders was instituted. The Option 1 – A differential surface that was the result of extensive computer modeling and was extensively evaluated by university, government and industry persons, a superior Class I advance price mechanism, the "higher of" pricing mechanism for Class I and common multiple component pricing provisions across all Orders using component pricing were all valuable improvements to the Federal Order program.

Even though the process was lengthy and thorough, the dairy industry is dynamic and changing and we currently find that provisions of the Order system need review and alteration. Areas that need review include the pricing provisions that were addressed in the Class III and IV hearing held last spring. (AO-14-A69, etc) The combination of an absolute versus a relative price surface that we now have and its interface with the prevailing pooling provisions is an issue that is now plaguing the industry and is being addressed at this and other hearings.

Federal Order Benefits and Principles

Federal Orders offer benefits to both producers and handlers and have always operated in a deliberate and organized manner guided by basic economic principles. Two primary benefits of Orders are to allow producers to gain from the orderly marketing of milk and to share the proceeds through market wide pooling. Orderly marketing embodies principles of common terms and pricing that attracts milk to move to the highest valued market when needed and clears the market when not needed. Market wide pooling allows **qualified** producers to share in the returns from the market equitably and in a manner that provides incentives to supply the market in the most efficient manner.

The Concept of a "Market"

Fundamental to Federal Order principles are the concepts of a marketing area (market) and the concept of "performance to the market" in order to be qualified to share in the returns from that market. The Federal Milk Order Market Statistics Annual Summary defines a marketing area as, *"...a designated trading area within which the handling of milk is regulated by the Federal Order."* It is clearly an identified geographic area and defined deliberately by a set of rules and for a specific purpose. In every set of Federal Order Regulations, Section 2 defines the geographic area of the marketing order.

Federal Order Reform sought out industry comment on marketing areas, established seven criteria for their establishment and then used those criteria to divide much of the lower 48 states into 11 Federal Order markets. The criteria and the Department's explanation of them, taken directly from the Final Rule are as follows:

"The same seven primary criteria **(the set of rules)** as were used in the two preliminary reports and the proposed rule were used to determine which markets exhibit a sufficient degree of association in terms of sales, procurement, and structural relationships to warrant consolidation **(the specific purpose)**. The Final Rule explained the criteria are as follows:

1. Overlapping route disposition. The movement of packaged milk between Federal Orders indicates that plants from more than one Federal Order are in competition with each other for Class I sales. In addition, a degree of overlap that results in the regulatory status of plants shifting between orders creates disorderly conditions in changing price relationships between competing handlers and neighboring producers. This criterion is considered to be the most important.

2. Overlapping areas of milk supply. This criterion applies principally to areas in which major proportions of the milk supply are shared between more than one Order. The competitive factors affecting the cost of a handler's milk supply are influenced by the location of the supply. **The pooling of milk produced within the same procurement area under the same order facilitates the uniform pricing of producer milk. Consideration of the criterion of overlapping procurement areas does not mean that all areas having overlapping areas of milk procurement should be consolidated. An area that supplies a minor proportion of an adjoining area's milk supply with a minor proportion of its own total milk production while handlers located in the area are engaged in minimal competition with handlers located in the adjoining area likely does not have a strong enough association with the adjoining area to require consolidation. For a number of the consolidated areas it would be very difficult, if not impossible, to find a boundary across which significant quantities of milk are not procured for other marketing areas. In such cases, analysis was done to determine where the minimal amount of route disposition overlap between areas occurred, and the criterion of overlapping route disposition**

generally was given greater weight than overlapping areas of milk supply. ¹ (emphasis added)

Some analysis also was done to determine whether milk pooled on adjacent markets reflects actual movements of milk between markets, or whether the variations in amounts pooled under a given order may indicate that some milk is pooled to take advantage of price differences rather than because it is needed for Class I use in the other market.² (emphasis added)

3. Number of handlers within a market. Formation of larger-size markets is a stabilizing factor. Shifts of milk and/or plants between markets becomes less of a disruptive factor in larger markets. Also, the existence of Federal order markets with handlers too few in number to allow meaningful statistics to be published without disclosing proprietary information should be avoided.

4. Natural boundaries. Natural boundaries and barriers such as mountains and deserts often inhibit the movement of milk between areas, and generally reflect a lack of population (limiting the range of the consumption area) and lack of milk production. Therefore, they have an effect on the placement of marketing area boundaries. In addition, for the purposes of market consolidation, large unregulated areas and political boundaries also are considered a type of natural barrier.

5. Cooperative association service areas. While not one of the first criteria used to determine marketing areas, cooperative membership often may be an indication of market association. Therefore, data concerning cooperative membership can provide additional support for combining certain marketing areas.

¹ Milk Procurement areas were considered as a criteria for Order 32 boundaries and the distant areas in question here were not found to be a part of the Order 's Marketing area.

² "Open pooling" was reviewed and was not considered to be criteria for deciding marketing area and certain areas were not put together as markets if their basis of commonality was for "economic paper pooling" versus meeting the criteria established. Additional analysis was done to make sure whether or not milk supplies that were associated with an Order (including those that were " paper-pooled") really should be a factor in determining the Marketing Area. In the case of Order 32 the distant milk in question here was not included in the marketing Area.

6. Features or regulatory provisions common to existing orders. Markets that already have similar regulatory provisions that recognize similar marketing conditions may have a head start on the consolidation process. With calculation of the basic formula price replacement on the basis of components, however, this criterion becomes less important. The consolidation of markets having different payment plans will be more dependent on whether the basic formula component pricing plan is appropriate for a given consolidated market, or whether it would be more appropriate to adopt a pricing plan using hundredweight pricing derived from component prices.

7. Milk utilization in common dairy products.

Utilization of milk in similar manufactured products (cheese v. butter-powder) was also considered to be an important criterion in determining how to consolidate the existing orders.”

64 Fed. Reg. 16045 (April 2, 1999).

The Final Rule went on to describe Federal Order 32 geographically and how the seven criteria were applied to form the boundaries for the marketing area.

“CENTRAL.

The consolidated Central order marketing area merges the current 9 Federal order marketing areas of Central Illinois, most of Southern Illinois-Eastern Missouri, most of Southwest Plains, Greater Kansas City, Iowa, Eastern South Dakota, Nebraska-Western Iowa, Western Colorado, and Eastern Colorado (Federal orders 50, 32, 106, 64, 79, 76, 65, 134, and 137, respectively). Moving to the consolidated Southeast marketing area are 6 Missouri counties currently in Federal order 32 and, from Order 106, 11 northwest Arkansas counties and 22 southern Missouri counties. Order 106 counties in Kansas and Oklahoma remain in the Central market. In addition, some counties in Colorado, Illinois, Iowa, Kansas, Missouri and Nebraska that currently are not part of any order area are included in the consolidated Central market. There are 543 counties and the City of St.

Louis, Missouri, in this consolidated area. The marketing area has changed from the proposed rule by the addition of the Western Colorado marketing area and seven currently unregulated Colorado counties, the elimination of 6 currently unregulated Missouri counties, the addition of two partial counties and the deletion of one partial county for the purpose of eliminating the inclusion of partial counties.

Geography.

The consolidated Central marketing area would include the following territory:

Colorado - 44 counties, including the 30 Colorado counties currently in the Eastern Colorado marketing area and the 4 Colorado counties in the Western Colorado marketing area. Ten currently-unregulated counties, 3 in the southeast corner of the state between the Eastern Colorado and Southwest Plains marketing areas, and 7 in the central part of the State between the Eastern Colorado and Western Colorado marketing areas, are added.

Illinois - 87 counties, including the 5 of the 6 counties currently in the Iowa marketing area (of the 2 partial Illinois counties in the Iowa marketing area, all of Whiteside and none of Jo Daviess are included in the Central area), the 19 counties currently in the Central Illinois marketing area, the 49 counties currently in the Southern Illinois-Eastern Missouri marketing area and 8 currently-unregulated adjacent counties in southern Illinois, and 6 currently-unregulated counties in western Illinois located between the current Central Illinois and Southern Illinois-Eastern Missouri order areas and the Mississippi River.

Iowa - 93 counties, including the 68 counties currently in the Iowa marketing area, the 17 counties currently in the Nebraska-Western Iowa marketing area, the 1 county currently in the Eastern South Dakota marketing area, 6 currently unregulated counties in the northwestern part of Iowa, and 1 currently unregulated county in the southeastern corner of Iowa.

Kansas - the entire State (105 counties).

Minnesota - the 4 southwestern Minnesota counties that currently are in the Eastern South Dakota marketing area.

Missouri - 39 counties and 1 city, including 6 of the counties and 1 city that currently are in the Southern Illinois-Eastern Missouri marketing area, the 20 counties that

currently are in the Greater Kansas City marketing area, the 5 counties that currently are in the Iowa marketing area; and 8 currently-unregulated counties distributed around the center area proposed to remain unregulated.

Nebraska - 66 counties in the southern and eastern parts of Nebraska; omitting the 11 counties in the panhandle that currently are part of the Nebraska-Western Iowa marketing area, and adding 5 currently-unregulated counties in the southwest corner of the State between the Nebraska-Western Iowa and Eastern Colorado marketing areas and 3 currently-unregulated counties in the southeast corner of the State between the Nebraska-Western Iowa and Greater Kansas City marketing areas.

Oklahoma - the entire State (77 counties).

South Dakota - the 26 eastern South Dakota counties (including the portion of Union County that currently is in the Nebraska-Western Iowa marketing area) that currently are in the Eastern South Dakota marketing area.

Wisconsin - the 2 southwest Wisconsin counties that currently are in the Iowa marketing area.

The consolidated Central marketing area is adjacent to the consolidated Upper Midwest order area on the north and northeast, the consolidated Mideast and Appalachian areas on the east, and the northwest corner of the Southeast order area and the consolidated Southwest area on the south and the consolidated Western order area on the west. The area north of approximately the western half of the consolidated Central area also is unregulated. The north-south distance covered by the area is approximately 800 miles, from Watertown, South Dakota, to Ardmore, Oklahoma. The east-west extent of the area, from the Indiana-Illinois border to the Colorado/Utah border, is approximately 1,200 miles.

Geographically, the Central marketing area includes a wide range of topography and climate types, ranging from the Colorado Plateau and the Rocky Mountains in the west to the central section of the Mississippi River Valley toward the eastern part of the area. Precipitation ranges from less than 15 inches per year in Denver, Colorado, to more than 30 inches at St. Louis, Missouri. Most of the area experiences fairly hot summer temperatures, while winter temperatures vary somewhat more than summer, with colder winter temperatures occurring in the northern and western parts of the Central area. The natural vegetation

ranges from desert and desert scrub in western Colorado through coniferous forest in the Rocky Mountains to short grass prairie in eastern Colorado through tall grass prairie in eastern South Dakota, Nebraska, Kansas and Oklahoma, and much of Illinois; to broadleaf forest on both sides of the Mississippi River.

Population.

According to July 1, 1997, population estimates, the total population in the consolidated Central marketing area is approximately 21.5 million. Using Metropolitan Statistical Areas (MSAs), there are four population centers over 1 million. The St. Louis, Missouri/Illinois, area is the largest, with over 2.6 million population, and the Denver-Boulder-Greeley, Colorado, area is next with approximately 2.3 million. Kansas City, Missouri/Kansas, has a population of 1.7 million, and Oklahoma City, Oklahoma, is just over 1 million. Approximately thirty-five percent of the population of the consolidated marketing area is within these four largest MSAs, with nearly two-thirds of the population contained within the area's 32 MSA's (with the 28 smaller MSAs averaging 228,559 population). The Colorado portion of the marketing area has 91.3 percent of its population concentrated in 5 MSA's. The Missouri portion has 94.4 percent concentrated in 3 MSA's.

Fluid Per Capita Consumption.

Based on the population figure of 21.5 million and a per capita fluid milk consumption rate of 19 pounds of fluid milk per month (a weighted average based on state populations in the marketing area and fluid per capita consumption estimates for each state), total fluid milk consumption in the consolidated Central marketing area would be approximately 408.5 million pounds per month. Plants that would be fully regulated distributing plants in the Central order had route disposition within the nine marketing areas included in the consolidated Central area of 366 million in October 1997. It is likely that most of the milk distributed within formerly unregulated areas by Central order handlers would be distributed within the consolidated Central marketing area. The 11 producer-handlers and 3 exempt plants operating in the Central market during October 1997 had a combined in-area route disposition of 3 million pounds, partially regulated plants distributed 2 million

pounds in the marketing area, and plants that are expected to be fully regulated under other consolidated orders distributed 59 million pounds in the Central marketing area during October 1997.

Milk Production.

In October 1997, 996.7 million pounds of milk were associated with the orders consolidated in the Central market (including all of the milk pooled under Orders 32 and 106). However, because of class price relationships in the Iowa and Nebraska-Western Iowa markets, only 893.2 million pounds of the milk was pooled. The 996.7 million pounds were produced by 9,900 producers located in 17 states; from Idaho to Kentucky, and from Texas to Minnesota. **Three-quarters of the milk associated with the Central market was produced within the consolidated marketing area. The states contributing the most producer milk were, in descending order of volume, Iowa, Colorado, Missouri, Kansas, Illinois and Oklahoma. However, 68 percent of the Missouri producer milk came from farms in counties which are included in the consolidated Southeast marketing area. These 6 States accounted for 71 percent of the producer milk associated with the nine current orders to be consolidated.** ³ (emphasis added) All of the states having substantial portions of their areas in the consolidated Central market contribute producer milk to at least two of the current nine individual orders, with five of the states (Iowa, Kansas, Minnesota, Missouri, and Nebraska) supplying milk to five of the order areas each.

Distributing Plants.

Using distributing plant lists included in the proposed rule and the pooling standards adjusted to 25 percent of route dispositions as in-area sales, updated for known plant closures through December 1998, 57 distributing plants would be expected to be associated with the Central marketing area, including 35 fully regulated distributing plants (all currently pool plants), 1 partially regulated (currently partially regulated), 3 plants exempt on the basis

³ After extensive analysis, which clearly considered some of the milk from distant locations in question at this hearing, none were included in the marketing area of Order 32. Also note that in several cases Order boundaries include only part of some states.

of size (currently pool plants but have less than 150,000 pounds of total route disposition per month), 13 producer-handlers (all currently producer-handlers), 1 unregulated plant (located in the unregulated central portion of Missouri), and 4 government agency plants (all currently government agency plants). Since October 1997, it is known that 1 pool distributing plant (in Illinois) and 1 partially regulated plant (in Wyoming) have gone out of business.

There would be 10 distributing plants in the Denver area (7 pool plants and 3 producer-handlers). The Kansas City area would have 1 pool distributing plant. The St. Louis area would have 6 distributing plants (4 pool plants, 1 exempt plant, and one producer-handler). There would be 1 pool distributing plant and 2 producer-handlers in the Oklahoma City area. Of the remaining 37 distributing plants, 19 are located in other MSAs as follows: 1 pool plant, 1 exempt plant (on the basis of size) and 1 producer-handler in Colorado; 1 pool plant in Illinois; 4 pool plants, 1 producer-handler and 1 exempt plant in Iowa; 1 pool plant in Kansas; 3 pool plants in Nebraska; 1 pool plant and 1 producer-handler in Oklahoma; 1 pool plant and 1 partially regulated plant in South Dakota, and 1 pool plant in Wyoming.

Eighteen of the remaining distributing plants are not located in MSAs. They are: 1 pool plant and 1 government agency plant in Colorado; 4 pool plants and 1 government agency plant in Illinois; 1 pool plant and 1 producer-handler in Iowa; 1 pool plant and 1 government agency plant in Kansas; 1 unregulated and 2 producer-handlers in Missouri; 1 producer-handler in Nebraska; 2 pool plants in Oklahoma; and 1 government agency plant in South Dakota.

Utilization.

According to October 1997 pool statistics for handlers who would be fully regulated under this Central order, the Class I utilization percentages for the individual markets ranged from 38 percent for the Southwest Plains market to 87 percent for the Central Illinois market. Class I (and Class II) receipts and utilization data for Iowa and the combination of Greater Kansas City and Eastern South Dakota markets are restricted to protect the confidentiality of individual handler information. Data for Eastern Colorado and Western Colorado

markets are combined in order to mask restricted data. Combined utilization for the nine markets would result in a Class I percentage of 50 percent.

Based on calculated weighted average use values for (1) the current order with current use of milk, and (2) the current order with projected use of milk in the consolidated Central order, the potential impact of this consolidation on producers who supply the current market areas is estimated to be: Southern Illinois-Eastern Missouri, a 27-cent per cwt decrease (from \$13.49 to \$13.22); Central Illinois, a 50-cent per cwt decrease (from \$13.56 to \$13.06); Greater Kansas City, a 69-cent per cwt decrease (from \$13.91 to \$13.22); Nebraska-Western Iowa, a 10-cent decrease (from \$13.23 to \$13.13); Eastern South Dakota, a 32-cent decrease (from \$13.33 to \$13.01); Iowa, a 5-cent decrease (from \$13.08 to \$13.03); Southwest Plains, a 70-cent increase (from \$12.94 to \$13.64); Western Colorado, a 65-cent decrease (from \$13.88 to \$13.23); and Eastern Colorado, an 11-cent decrease (from \$13.70 to \$13.59). The weighted average use value for the consolidated Central order market is estimated to be \$13.29 per cwt. ⁴ (emphasis added)

Other Plants.

Located within the Central marketing area during May 1997 were 84 supply or manufacturing plants: 8 in Colorado (4 in the Denver area), 15 in Illinois (2 in the Decatur area), 23 in Iowa (2 in the Des Moines area and 1 in the Dubuque area), 6 in Kansas, 7 in Missouri (5 in the St. Louis area), 7 in Nebraska, 7 in South Dakota (1 in the Sioux Falls area), 4 in Oklahoma (1 in the Tulsa area), and 7 in Wisconsin. Twenty-two of the 84 plants are pool plants, or have a "pool side." Twelve of the 22 pool plants (6 in Iowa, 1 in Nebraska, 2 in South Dakota, and 3 in Wisconsin) are "split plants;" that is, one side of a plant is a manufacturing facility, and the other side receives and ships Grade A milk, and accounting is done separately. In most cases, the

⁴ Neither the utilization calculations nor the resulting blend calculations included the milk from distant locations in question here as a part of Federal Order 32. Note also that the projected utilization for the Central Order was 50%!

nonpool portion of such a plant is a manufacturing operation, primarily cheese-making. Of the pool plants, 8 have no primary product, but are only shipping to distributing plants, and 6 are pooled manufacturing plants.

Of the 62 nonpool plants in the consolidated Central marketing area, 59 are manufacturing plants -- 24 are plants that manufacture primarily Class II products, 3 manufacture primarily butter, 6 manufacture primarily powder, 25 manufacture primarily cheese, and 1 manufactures primarily other products.

Also associated with the consolidated Central order, but not within the marketing area, are 2 nonpool cheese plants and a nonpool supply plant located in South Dakota.

Cooperative Associations.

Twenty-five cooperative associations pooled milk in December 1997 under the nine orders consolidated in the Central market. Of these cooperatives, 1 pooled milk under 7 of the orders, 5 cooperatives associated producer milk with 3 orders each, and 2 others pooled milk under 2 orders each. Seventeen of the 25 cooperatives pooled milk under only one order, and for 10 of these organizations that was the Iowa order.

The percentage of cooperative milk pooled under the eight orders was 95, with a range of 80.7 percent cooperative milk under the Southwest Plains order to 100 percent cooperative member milk under the Central Illinois, Greater Kansas City and Eastern South Dakota orders.

Criteria for Consolidation.

Most of the criteria used in determining the optimum consolidation of order areas apply to the Central marketing area. The Federal order markets consolidated in the Central area are strongly related to each other through overlapping route disposition. The great majority of sales by handlers who would be regulated under the consolidated Central order are distributed within the marketing area, and the consolidated markets have a greater relationship in terms of overlapping sales areas than with any other markets. In addition, sales within the currently unregulated areas included in the consolidated Central area are overwhelmingly from handlers that would be pooled under the Central order. Inclusion of these areas would reduce handlers' burden of reporting out-of-area sales and take in pockets of currently

unregulated counties that occur between the current order areas. **As discussed above, the milk procurement areas for the consolidated markets also have a significant degree of overlap.** ⁵ (emphasis added)

The Western Colorado order is included because the more recent data collected for this final decision indicates that since the proposed rule the Western Colorado marketing area has developed a closer relationship with the Eastern Colorado market than with any other market, even across the Continental Divide. A benefit of combining Western Colorado with other markets is that it is a small market where data cannot be released without revealing confidential information unless combined with data pertaining to another marketing area. Consolidation of the area will allow publication of meaningful statistics without disclosing proprietary information. In addition, several comments supported the combination of the Western Colorado area with the consolidated Central market in view of the large negative effect of lower producer pay prices on the small number of producers involved if the Western Colorado area were consolidated with the Southwestern Idaho-Eastern Oregon and Great Basin marketing areas.

Some of the currently-unregulated counties in western Illinois and central Missouri have been added to the Central marketing area. The omission from the marketing area of the counties in central Missouri that are not included in the consolidated Central marketing area are based on an estimation of the marketing area of Central Dairy, located in Jefferson City, Missouri. This handler has not been previously regulated. As discussed earlier, it is not the intent of this decision to include currently-unregulated area in the consolidated order areas where such inclusion would have the effect of regulating previously-unregulated handlers.

An additional benefit of the consolidation of these nine order areas is that data will be able to be made public without disclosing proprietary information. Four of the current Federal order markets (Central Illinois, Greater Kansas City, Eastern South Dakota, and Western Colorado) included in this consolidated area have too few pool plants to be able to publish market data without revealing confidential information. In addition to these three markets, the number of handlers regulated under each of the

⁵ The source for much of the milk from distant locations under consideration at this hearing were specifically excluded from the Central Order marketing area.

Nebraska-Western Iowa, Iowa and Eastern Colorado orders
is in the single digits.

Discussion of Comments and Alternatives.

Prior to issuance of the proposed rule, alternatives to the consolidation of the order areas included in the Central marketing area that were considered included combining the Iowa, Nebraska-Western Iowa, and Eastern South Dakota order areas with those of the Chicago Regional and Upper Midwest areas in a consolidated Upper Midwest order. The collection of more detailed data concerning the overlap in route disposition and milk procurement showed clearly that these marketing areas are more closely related to markets to the south than to the north. ⁶ (emphasis added)

Approximately 85 percent of the total fluid milk dispositions distributed by handlers regulated under the three order areas that were suggested to be included in the Central area in the initial Preliminary Report, and in the Upper Midwest area in the Revised Preliminary Report, are disposed of in the consolidated Central market. The disposition by other Central marketing area handlers within the consolidated Central area is somewhat greater than the proportion for the three more northern order areas.

Also considered was the exclusion of 14 Nebraska counties, in addition to the 11 already excluded, from the Central marketing area to expand the unregulated area in which Gillette Dairy could distribute milk without becoming regulated. There was no data indicating that Gillette distributes milk in those counties. In the early stages of the study of appropriate order consolidation, it was assumed that the southern Missouri and northwest Arkansas portions of the Southwest Plains order area would remain with the rest of that area. This area was included with the consolidated Southeast order area in the proposed rule, and remains there.

Eighteen comments that pertained specifically to the proposed Central marketing area were filed by 17 commenters in response to the proposed rule. Four of these comments advocated moving the Western Colorado order area from the consolidated Western order to the consolidated Central order. These comments expressed concern about the expected reduction in the blend price to

⁶ Specific consideration was given for inclusion of the areas in question here and those areas were expressly excluded from the Central Order marketing area.

Western Colorado producers under the Western order. An examination of updated data on route dispositions and bulk milk movements resulted in making this change, which is explained in greater detail in the description of comments and alternatives under the section of this decision dealing with the Western area.

A comment filed by the American Farm Bureau Federation recommended that the central area of Missouri that was proposed to be unregulated be included in the Central order area. A comment filed on behalf of Central Dairy, the handler who is located and distributes milk in the unregulated Missouri area opposed the addition of any presently unregulated territory to Federal order marketing areas, and specifically opposed the addition of six currently-unregulated northeast Missouri counties into which the handler expects to expand its distribution. There is no intention of causing the regulation of this handler. As discussed earlier with regard to the Northeast and Mideast marketing areas, consolidation of the existing orders does not necessitate expansion of the consolidated orders into currently unregulated areas, especially if such expansion would result in the regulation of currently unregulated handlers. At the same time, minimizing the extent of the unregulated counties in the middle of the consolidated marketing area would help to reduce the reporting burden on handlers in determining which route dispositions are inside, and which are outside the marketing area. The administrative burden of verifying such reporting also would be eliminated. Six currently-unregulated northeast Missouri counties that were proposed to be added to the Central order area have been removed on the basis of comments received from the Jefferson City handler, who indicated that regulation of the six counties may result in a change in the handler's regulatory status. No urgency on the part of regulated handlers having sales in the unregulated area to include that area in the consolidated order area was apparent from comments. In fact, none of the comments received from affected handlers advocated that the unregulated area be included in the consolidated area.

A comment by Gillette Dairy, a handler located in Rapid City, South Dakota, in the former Black Hills Federal order area, supported excluding the 11 counties of the Nebraska panhandle, currently part of the Nebraska-Western Iowa order area, from the consolidated Central area.

Gillette has some sales in this area and competes there with regulated handlers, but requested that the panhandle area be excluded to lessen Gillette's likelihood of becoming fully regulated under the Central order. This area was excluded in the proposed rule, and its exclusion was unopposed by any interested persons who filed comments before the deadline for doing so. Although Gillette's sales in the panhandle area do not represent an overwhelming majority of the total sales there, the volume of sales in this sparsely populated area should not affect the competitive status of any regulated handlers. Therefore, the area will be excluded from the consolidated area as proposed.

Several comments, from the Iowa Department of Agriculture, Wells' Dairy, and Anderson-Erickson Dairy, as well as Swiss Valley Farms, supported the inclusion of the Iowa order area in the consolidated Central area, stating that the attraction of a supply of milk for fluid needs requires such a consolidation.

Comments were received on dividing the current Iowa marketing area by adding the eastern edge of the Iowa marketing area to the proposed consolidated Upper Midwest order. Such a division would result in the Swiss Valley Farms distributing plant in Dubuque, Iowa, qualifying as a pool plant under the consolidated Upper Midwest order (as it now does during some months under the current Chicago Regional order). The Swiss Valley plant comprises a large majority of the Iowa market sales in the Chicago Regional and Upper Midwest order areas, and the movement of a half-dozen counties would assure its pool status in the consolidated Upper Midwest order and its location in that order area.

Comments by Lakeshore Federated Dairy Cooperative argued that the extensive overlap of producers, Class I sales, and geographic similarities between the northeast portion of the Iowa marketing area and the adjoining consolidated Upper Midwest area should be considered compelling reasons for making such a change. Lakeshore's comments were supported by Prairie Farms, Foremost Farms, and DFA. In addition, Grande Cheese Company, a Wisconsin cheesemaker, filed comments supporting Lakeshore's position.

In its comments, Swiss Valley argued that the 2 southwest Wisconsin counties proposed to be included in the consolidated Central marketing area were removed from the

Chicago Regional area and added to the Iowa area on the basis of a formal rulemaking proceeding in the late 1980's, at which time it was determined that the principal competition for fluid sales and milk supply in this area occurred between Iowa handlers rather than with Chicago Regional handlers. It is therefore Swiss Valley's position that the two counties should remain with the rest of the Iowa area, in the consolidated Central marketing area.

On the basis of data gathered for this decision, the primary source of route disposition in Grant and Crawford Counties, Wisconsin, and Dubuque County, Iowa, is the Swiss Valley plant in Dubuque, and most of the rest of the milk distributed in these counties is from handlers regulated under the Chicago Regional order. The data also shows that the Dubuque plant procures most of its milk supply from counties that also supply milk to the Chicago Regional and Upper Midwest orders, as well as to other plants pooled under the Iowa order.

One of the problems in this marketing area has been the ability of the Swiss Valley plant to choose the order under which it is regulated. As a result of differences between the current pool plant definitions of the two orders, Swiss Valley has been able to switch regulation between the Iowa and Chicago Regional orders as its price advantage shifted, and has done so frequently during 1997 and 1998. The pool plant definitions of the consolidated Upper Midwest and Central orders, which are very similar, will require that the Swiss Valley plant be regulated under the order for the area in which it has the greater volume of route disposition.

If, under the consolidated orders, the Dubuque plant distributes a greater share of its sales in the consolidated Upper Midwest area than in the consolidated Central area, the plant will be pooled under the Upper Midwest order. The only appropriate change to be made to the current Iowa marketing area is to eliminate the partial counties from the marketing area definitions of the consolidated Central and Upper Midwest orders.

The Illinois Counties of Jo Daviess and Whiteside currently are split between the Iowa and Chicago Regional order areas. More than half of the sales in Whiteside County are supplied by Iowa handlers (including Swiss Valley), so Whiteside County will be located entirely within the consolidated Central area. More than half of the sales in Jo Daviess County are supplied by Chicago Regional handlers

(not including Swiss Valley), and that county will be located entirely within the consolidated Upper Midwest area. The Iowa County of Mitchell currently is located in the Upper Midwest area except for the City of Osage, which is defined as part of the current Iowa marketing area. All of Mitchell County will be included in the consolidated Upper Midwest area.

After considering all comments and other relevant information, it is determined that the territory encompassed in the Central marketing area best meets the criteria used.

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The Concept of Pooling Market Proceeds

All Federal milk orders today, save one, provide for the marketwide pooling of milk proceeds among all producers supplying the market. The one exception to this form of pooling is found in the Michigan Upper Peninsula market, where individual handler pooling has been used.

Marketwide sharing of the classified use value of milk among all producers in a market is one of the most important features of a Federal milk marketing order. It ensures that all producers supplying handlers in a marketing area receive the same uniform price for their milk, regardless of how their milk is used. This method of pooling is widely supported by the dairy industry and has been universally adopted for the 11 consolidated orders.”

64 Fed. Reg. 16130 (April 2, 1999).

Additionally, each Order has precise terms that a supplier must follow in order to share in the blend proceeds. These provisions are known by the industry as “**performance standards**”. This concept is explained, defended and endorsed in the Final Rule as follows:

“There were a number of proposals and public comments considered in determining how Federal milk orders should pool milk and which producers should be eligible to have their milk pooled in the consolidated orders. Many of these comments advocated a policy of liberal pooling, thereby allowing the greatest number of dairy farmers to share in

the economic benefits that arise from the classified pricing of milk.

A number of comments supported identical pooling provisions in all orders, but others stated that pooling provisions should reflect the unique and prevailing supply and demand conditions in each marketing area. **Fundamental to most pooling proposals and comments was the notion that the pooling of producer milk should be performance oriented in meeting the needs of the fluid market. This, of course, is logical since a purpose of the Federal milk order program is to ensure an adequate supply of milk for fluid use.⁷ (emphasis added)**

A suggestion for "open pooling," where milk can be pooled anywhere, has not been adopted, principally because open pooling provides no reasonable assurance that milk will be made available in satisfying the fluid needs of a market.⁸ (emphasis added) Proposals to create and fund "stand-by" pools are similarly rejected for the same reason.

The pooling provisions for the consolidated orders provide a reasonable balance between encouraging handlers to supply milk for fluid use and ensuring orderly marketing by providing a reasonable means for producers within a common marketing area to establish an association with the fluid market. Obviously, matching these goals to the very disparate marketing conditions found in different parts of the country requires customized provisions to meet the needs of each market.

For example, in the Florida marketing area, where close to 90 percent of the milk in the pool will be used for fluid use, pooling standards will require a high degree of association with the fluid market and will permit a relatively small amount of milk to be sent to manufacturing plants for use in lower-valued products.

⁷ The concept of a performance standard is fundamental to the Federal Order System and was endorsed by both the industry and the Secretary.

⁸ "Open pooling" was totally rejected in the Reform deliberations by the Secretary.

In the Upper Midwest market, on the other hand, a relatively small percentage of milk will be needed for fluid use. Accordingly, under the pooling standards for that order smaller amounts of milk will be required to be delivered to fluid milk plants and larger amounts of milk will be permitted to be sent to manufacturing plants for use in storable products such as butter, nonfat dry milk, and hard cheese. The specific pooling provisions adopted for each order are discussed in detail in the sections of this document pertaining to each of the consolidated orders."

64 Fed. Reg. 16130 (April 2, 1999).

We find no compelling reason to change this guideline. Open pooling is a cause for concern from our group's members in Federal Order 32. They are concerned when milk from distant areas shares in the blend price pool but does not perform – that is does not deliver regularly nor balance the market. The cost of providing those services to the market always falls back on the local milk supply. And if current practice is not amended it will guarantee a continuing lower return for the local dairy farmers who supply the local Class I market! The resulting draw of blend price funds to distant producers who do not perform is not reasonable. It was analyzed and excluded by Order Reform and thus is an "end run" that should not be allowed now.

Additionally, "open pooling" has an inherent conflict with the principles underlying the models that formulated the price surfaces derived in Reform. The differential models assumed that supplies of milk associated with a demand point and aggregated into a market, actually shipped from the counties they were located in to the population centers where the demand points were fixed. To the best of our knowledge there were no provisions in the mathematical equations for those models allowing for milk to be associated with a market if it did not actually ship to or supply the market. The current practices clearly exploit that price surface and if we are to retain it, which we support doing, we must structure the regulations to parallel the model!

This means that using direct deliveries from inside the marketing area to qualify supply plants and milk supplies from outside the marketing area should be greatly limited if allowed at all.

The principle of allowing direct ship milk to qualify a supply plant was instituted to allow achievement of the economies of direct shipped milk - saving the cost of reload and pump over. It is now being used for another

purpose – to substitute milk produced in the market for supplies located far out of market in the qualification equation. This runs counter to the initial intent of the provision and to the principles that formed the pricing grid.

It is our position that milk supplies located in the marketing area should not be used to qualify distant milk. Milk deliveries that are used to qualify supply plant that are located outside of the marketing area should also originate outside of the marketing area from locations equidistant to the market as the supply plant. This way, the principles that underlie the pricing surface could be adhered to but still allowing for the economies that come from direct ship milk. The accounting for this practice would be no more difficult to administer than similar practices that govern transportation credits in Orders 5 and 7 or the surplus milk pricing adjustments that existed in the Texas Order prior to Reform.

Performance standards are universal in their intention – to require a level of association to a market that marked by the ability and willingness to supply that market. However, they are individualized in their application. Each market requires standards that work for the conditions that apply in that market. The Reform record develops and defends this concept.

A review of the various Federal Order performance standards shows the diversity of standards, but the common requirement of performance to the market in order to share in the blend price pool. During the Reform process as individual Order performance standards were being evaluated many times a particular standard was chosen from one of the predecessor Orders. Frequently the most lenient standard was selected from among a group of available choices. This attempt, however good in its intent, has not always proven to be workable and is one of the reasons for this proceeding.

Exhibit 9, Table 1 titled **Pounds of Milk Used In Class I Products** shows a table of annual Class I usage for all Federal Orders. Note that Federal Order 32 has the 3rd largest volume of Class I usage in all Orders. Clearly Federal Order 32 represents a major market for Class I milk and the performance requirements associated with it should reflect that by providing for sufficient association and performance to the market in order to share in the blend price. We note that several other markets with smaller total Class I sales volumes have more restrictive pooling standards.

Exhibit 9, Table 2 titled **Summary of Producer Milk Provisions Under Federal Milk Marketing Orders** is a comparison of Federal

Order producer milk standards. Note that while the intentions of the various standards are the same – to establish the requirements necessary to share in the Orders proceeds, the specifics vary from Order to Order.

Exhibit 9, Table 3 titled **Summary of Minimum Pooling Standards for Supply Plants Under Federal Milk Orders** is a comparison of Federal Order pooling standards. Again, note that while the intentions of the various standards are the same – to establish the requirements necessary to share in the Order proceeds, the specifics vary from Order to Order. Note that several Orders call for an automatic pool qualification period commonly referred to as a “free ride period”. This term means that some level of performance in a prior period grants the performer a benefit in a future period that does not require a performance during that time frame.

Exhibit 9, Tables 5 – A & B titled - **Comparison of Relative Return Between Markets Federal Order 1005 & Federal Order 1032** and Tables 6 A & B - **Comparison of Relative Return Between Markets Federal Order 1007 & Federal Order 1032** - demonstrates that the blend price for the St Louis, Missouri market and for the Tulsa, Oklahoma market is not sufficient to prevent milk supplies from being attracted to the adjoining southeastern Federal Orders.

Nashville, Illinois and Jackson Missouri represent milk sheds that traditionally supply the St Louis market. Recently producers in these milk sheds have requested that their milk be marketed in Federal Order 5 due to higher returns.

Review of the blend price at Madisonville Kentucky, (Table 5 – A) a nearby Federal Order 5 pool distributing plant that solicits for milk supplies in these areas, clearly demonstrates why producers in this area are seeking the adjoining market. On a CY 2000 annual average basis, after adjusting for the haul, producers from Nashville, Illinois would be \$1.52 per hundredweight better off from a Federal Order 5 return. In the worst individual monthly comparison, January 2000, a producer would be \$0.92 per hundredweight better off and in the best month, November 2000, \$2.74 per hundredweight. Similar comparisons for a Jackson, Missouri area producer show a net annual average per hundredweight gain of \$1.80. The lowest individual monthly comparison January 2000 shows a gain of \$1.19 per hundredweight while the November 2000 gain is \$3.01 per hundredweight.

Table 5 - B details comparisons for CY 2001 year to date showing that these trends are consistent with CY 2000 data.

Ada, Oklahoma represents a milkshed that traditionally supplies the Tulsa, Oklahoma market. Recently producers in this milk shed have requested that their milk be marketed in Federal Order 7 in order to obtain a higher return.

Review of the blend prices at Ft. Smith or Little Rock, Arkansas, (Table 6 – A) both nearby locations for Federal Order 7 pool distributing plants, clearly demonstrates why producers in this area are seeking the adjoining market. On an annual average basis, **after adjusting for the haul**, producers from Ada, Oklahoma would be \$0.65 per hundredweight better off from a Federal Order 1007 return at Little Rock. In the worst individual monthly comparison, January 2000, a producer would be \$0.11 per hundredweight better off marketing their milk to the Order 1032 plant - **the only month in CY 2000 that the return would be better in the local market than in the adjoining market.** The best month, November 2000, the adjoining market return would be \$1.59 per hundredweight more. Similar comparisons for a Fort Smith, Arkansas sale show a net annual average gain of \$1.25. The lowest individual monthly comparison January 2000 shows a gain of \$0.49 per hundredweight while the November 2000 gain is \$2.19 per hundredweight.

Table 6 – B details comparisons for CY 2001 year to date showing that these trends are consistent with CY 2000 data.

Exhibit 4 Tables 7 – A & B titled - **Comparison of Relative Return Between Markets Federal Order 1030 & Federal Order 1032** demonstrates that the blend price in Order 32 **is not sufficient to attract milk from an adjacent Federal Order** to replace the milk that is attracted away to other Federal Orders. For practical purposes Federal Order 30 and Southwest Wisconsin would be the most logical replacement location for the St Louis market. However, Table 7 - A demonstrates that in every month of CY 2000 the Federal Order 32 blend price less the haul from Southwest Wisconsin would be less than the Federal Order 1032 price in St Louis. The annual average loss is \$0.55 per cwt. This ranges from a least loss of 35 cents to a maximum shortfall of 74 cents.

An additional comparison was made for milk supplies in Melrose MN (Stearns County) and Des Moines IA – the location of a major pool distributing plant in Order 32 and a logical reserve supply for the Des Moines area. Also, Stearns County is major milk production area in Minnesota. There to, the annual average advantage that Order 30 has over Order 32 is -\$0.82/cwt, ranging from -\$0.62 to -\$1.01 per cwt.

Exhibit 9 Table 8 A & B titled - **Comparison of Relative Return Between Markets Federal Order 1126 & Federal Order 1032** demonstrates that the blend price in Order 32 **barely sufficient to attract keep milk from moving to Federal Order 126 in spite of a 317 mile haul!** In CY 2000 the spread between blend prices got as narrow as six cents in November and averaged 48 cents for the year. Through August 2001 the CY 2001 average was nearly the same. Thus only a small shift in prices could cause FO 126 to become a more attractive market than Order 32 even after a long haul.

DFA milk production in the former Western Colorado Federal Order marketing area, now encompassed by the Central Order, has declined by 15% since the implementation of FO Reform. The number of farms has dropped from 20 to 16. Several farms in the area had been developing expansion plans but have curtailed those plans due to lower blend prices.

This area is very isolated. There is limited if any competition for milk sales in this area due to the distance from other fluid bottlers. Producers have no other market outlets due to the distance to other markets. The record developed during the Federal Order Reform process noted that perhaps this area could have "stood alone" had not the mandate of "10 -14 Orders" been in force. There have been no changes in the handler makeup in the area, no change in production conditions, little change in the differential level – but the new Order regulations reduces the blend price severely enough to curtail production.

As a result of returns that are too low and alternatives that are better producers are and will continue to leave Federal Order 1032 markets. As over all blend prices decline due to the effect of non performing milk supplies, individual handlers will be able to offer small groups of producers higher prices representing slices of the market at utilization rates higher than the market average and then pit producer versus producer in the race to sell for less. Also, procurement schemes will "pop up" to exploit a specific blend price advantage that will benefit some producers at the expense of most of the others. The end result is that after prices fall to the lowest level, supplies will attempt to rationalize and then conditions will normalize. But over the time that this occurs producers will lose revenues. It would be far more orderly and less costly to all producers to correct the blend price alignment now rather than over the longer time period that it takes to otherwise correct these price misalignments.

The magnitude of the difference cannot be corrected with over order premiums. Increases of the magnitude needed to solve the problem, over a dollar per hundredweight in the cases cited above, would accelerate the

disorderly marketing conditions outlined in the above paragraph. None of the markets could institute a charge of that magnitude.

Exhibit 9, Table 9 – A & B titled - **Utilization and Statistical Uniform Blend Price Federal Order 32** show pounds pooled by month on Federal Order 32 from January 2000 to date taken from monthly Order statistical publications. Exhibit 9, Chart 1 drawn from this data details this information on an indexed basis. For each month, Class I and Class II usage is combined, converted to a pounds per day basis and then indexed with January 2000 as the base. Identical computations for Class III and Class IV utilizations are made. Class I and II usage represents the products from which added value is derived for the pool. Class III and IV usage represents the products that maintain the reserve supply for the added value products and serves to balance the fluctuating demands of the market. Clearly the volume of Class I and II usage has changed little in the 22 months of Reform for Federal Order 32. But the supply of “reserve” has grown steadily. It will be difficult to justify the need for a near 187% increase in the reserve associated with the market.

Exhibit 9, Table 11 furnished by the Market Administrator, illustrates the source and volume of all milk that is pooled on Order 32 for each month that the Reformed Order 32 has been in existence. The maps Exhibit 9, Table 12 labeled Counties With Milk Marketing’s on the Central Federal Order for the periods September 2000 and September 2001 exhibit this detail graphically. MA Exhibit 9, Table 12 continued delineates this same data from the standpoint of sourced from “inside the marketing area” versus “outside the marketing area” for the same period.

Several conclusions can be drawn from these data:

- 1) For these months about 45% of the producer receipts came from farms located in counties located outside of the marketing area.
- 2) As best evidenced by the maps, much of the milk is from such long distance that it cannot serve the market easily on a regular basis.
- 3) There was a learning curve to the “art” of “open pooling” as best evidenced by the Minnesota and Wisconsin data. Clearly, poolings slowly increased as handlers realized the potential “income opportunity” and the ease of obtaining it. Once the methodology became understood the volume pooled increased heavily.

- 4) The "free ride" months (May – July) became a temptation that could not be ignored. Examination of the data for the leading states in the source of distant milk pooled on the Order - Minnesota and Wisconsin show this factor. In both cases CY 2000 poolings increased in the "free ride" months as the learning curve of how best to exploit "open pooling" advanced. Then poolings tapered somewhat. In CY 2001 they cycle repeated as the "free ride" months' poolings again represented the months of largest volume pooled on the Order.
- 5) California, the other leading state in the "open pooling derby" had no poolings in CY 2000 but the same pattern of noticeable increases in poolings is evident in CY 2001. Perhaps evidence that the lessons of the prior year had been learned well.
- 6) Market Administrator data has been published in map and table form for every Federal Order. Data has been published similar to Exhibit ~~45~~, Table 12 for May 2000. For comparison purposes every other Federal Order except the Appalachian Order had more milk pooled and produced from within its marketing area boundaries than did the Central Order – reported at 43.6% for the May 2000 period. The next lowest percentage was the Southeast Order at 69.4%.

Clearly Order 32 is carrying an excessive volume of reserve supply. Looking at the Index Chart, (Exhibit ~~4~~ Chart 1) Class I and II usage has been relatively constant each month. Data from Exhibit ____ Tables 9 –A & B would indicate that this volume is approximately 500 million pounds per month. Given the reality that milk production is reasonably level throughout the week and fluid use demand is variable, how much is a reasonable reserve? We would pose that a **charitable** assumption for a necessary reserve would equal a three-day supply. That is, demand for Class I & II is higher on four days of the week and lower to non existent on three days, therefore a reasonable reserve would be 3/7 or 42.8%. Put in another way, this represents weekend balancing and/or the supply needed to serve peak weekly demand fluctuation. Every market should be responsible for maintaining a reserve supply. The dairy farmer member owners of our group recognize that responsibility and are willing to accept it. However, we do not accept the responsibility for maintaining a greater reserve supply than necessary.

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Tables 12

Therefore given the assumption of a reserve supply at 42.8% and a fluid use average demand of 500 million pounds, a reasonable calculation of a reserve supply would be 214 million pounds per month.

Looking again to the Index Chart, the CY 2001 data for Class III and IV appears to have stabilized at a higher level and looking to the usage tables at an average volume of 997 million pounds. This would equal a reserve of 4.65 times more than the charitable 42.8% standard. Looking again to MA Exhibit 12 we can see that milk from "other counties", that is those that are not located within the marketing area as established by Federal Order Reform, 601 million pounds in September 2000 and 657 million in 2001. This would be double to triple the amount of reserve supply needed by the market – again using our charitable estimate.

Just to get the perspective of another month, looking to the data requested by DFA from the Market Administrator, the milk pooled on the Order for December 2000 from counties within the seven state area but outside the marketing area show a reserve that would be three and one half times larger than the 214 million pound estimate.

Even taking into consideration the amount of Class III and IV manufacturing use that has been in the market for many years the current volumes of produce milk pooled must be considered excessive and in no way can be considered a necessary reserve to the market.

Exhibit 9, Table 4 titled - **Mileage Data Used in Various Computations and Comparisons** lists the mileages from certain supply points located outside the marketing area in counties and cities within those counties that pooled on the market listed in Market Administrator data. The demand points chosen represent major population centers within Order 32 or the cities for which alternative price comparisons were made. Unless otherwise noted the rate per mile used in the calculation is \$1.90 and a reasonable proxy for one-way transportation costs. This cost does not include any procurement, assembly or reload costs – just the transportation component.

Exhibit 9, Tables 10 – 15 titled – **Comparison of Delivery Charges Versus Producer Price Differential** (for several different markets), depict the return from deliveries from several distant supply points to Federal Order 32. The volumes chosen indicate easy arithmetic and are not intended to represent any actual receipts. However, the per-unit calculations would be representative. The comparison uses the mileages shown in Exhibit 9, Table 4.

Exhibit 9, Table 10 shows a return calculation based on a California and Idaho supply point as if the milk was delivered to the market every day – which is the most typical practice for local milk. The return is shown in the column labeled “Monthly Return All Delivered to Bottler”. This return is calculated by netting the difference in the producer price differential from the destination point against the transport costs. The effect of any additional procurement costs and market premiums are ignored. If this milk were delivered to the market every day the blend price gain would not even be enough to pay the transportation costs. No rational supplier would make this business decision to **lose** \$1.2 million dollars or approximately \$5.72 cents per hundredweight in the case of the California delivery or \$833,526 / \$3.97 per cwt in the case of the Idaho delivery.

However, the easy producer association standard and the loose diversion standard make a one-time delivery of 32,587 pounds able to qualify the entire volume and turn the significant loss into gains of \$280,582 (CA delivery) and \$281,157 (ID delivery). All that is necessary is to touch base one time and not lose association with the Order. Since California has no Federal Order plants it is easy to remain unassociated with a Federal Order plant. Since there are currently no pool supply plants in Federal Order 135 – the Western Order any delivery to an Idaho manufacturing plant will not cause loss of association with the Central Order. Also the pooling handler must have sufficient sales to qualify the diversion. A standard made easy by the Central Order provisions which allow the ability to “pyramid deliveries” in order to qualify larger volumes of milk.

Table 11 uses the same calculation method but applies the delivery standards of 20% and 25% that we propose and the gains are reduced greatly. In the scenario of a California delivery they remain negative and in the case of the Idaho delivery they result in a \$0.21 / cwt return. The \$0.21 per cwt may not be sufficient to draw the milk away from the manufacturing plant – unless the intent is not to ever ship but to just “ride the pool”.

Note that this example does not consider the possibility that local in area milk could qualify the milk in this example and thus affect the return, but only considers how our proposal would work if this milk were to be forced to perform on its own. Our proposals do address this issue however. Also Proposals 8 and 9 will speak to other requirements for the pooling of distant milk from individual members of our group.

Clearly however, if based on economic factors alone this milk would rarely if ever deliver to the market on a regular basis.

Exhibit 9, Table 12 shows a return calculation based on two Wisconsin counties Buffalo and Manitowoc. These were chosen as two counties with large volumes of milk pooled on the Central Order in December 2000 but no pounds pooled in December 1998. They also represent counties from different milksheds within the state. The towns of Cream (Buffalo – which had the largest volume in CY 2000 from a zero CY 1998 base) and Manitowoc (Manitowoc county) are located in each county. St Louis was selected as a likely demand point since is the major consumption point in the market and in a location most likely to be served by these supply points.

If milk were delivered to the market every day from these two locations, which is the most typical practice for local milk, it would generate a negative return as shown in the column labeled "Monthly Return All Delivered to Bottler". This return is calculated by netting the difference in the producer price differential from the destination point against the transport costs. The effect of any additional procurement costs and market premiums are ignored. If this milk were delivered to the market every day the blend price gain would not even be enough to pay the transportation costs. No rational supplier would make this business decision to **lose** \$123,000 or approximately \$0.59 cents per hundredweight in the case of the Buffalo County delivery or \$92,850 / \$0.44 per cwt in the case of the Manitowoc County delivery.

With the easy producer association standard and the loose diversion standard however, a one-time delivery of 32,587 pounds able to qualify the entire volume and turn the losses into gains of \$282,265 (Buffalo Cty delivery) and \$282,314 (Manitowoc Cty delivery). All that is necessary is to touch base one time and not lose association with the Order. Since these counties are in the marketing area of Federal Order 30 it is a little more difficult to avoid becoming associated with that Order and losing association with Order 32. But, Order 30 and 32 recognize the "split plant" provision making it somewhat easier to remain unassociated with Order 30 as a delivery to the nonpool side of a "split" manufacturing plant would not cause loss of association. As before, the pooling handler must have sufficient sales to qualify the diversion. A standard made easy by the Central Order provisions which allow the ability to "pyramid deliveries" in order to qualify larger volumes of milk.

Table 13 uses the same calculation method but applies the delivery standards of 20% and 25% that we propose and the gains are reduced. In the scenario of a Buffalo County delivery they are reduced from \$1.34 down to \$0.93 per hundredweight and in the case of the Manitowoc County delivery down to \$0.96 / cwt. Again this return must be compared

with the return generated by the manufacturing plant, if the milk is to ship to the market every day and also with the Order 30 return. In our experience producer premiums in Order 30 are among the largest that we know of. Marketing this milk to St Louis every day would not generate enough dollars to attract and retain a milk supply.

Note again that this example does not consider the possibility that local in area milk could qualify the milk in this example and thus affect the return, but only considers how our proposal would work if this milk were to be forced to perform on its own.

Clearly however, if based on economic factors alone this milk would rarely if ever deliver to the market on a regular basis.

Exhibit 9, Table 14 shows a return calculation based on Stearns County, Minnesota and the city location of Melrose. Stearns County had the second largest volume of milk pooled on Order 32 from a Minnesota county overall but had zero pounds pooled in December 1998. It is also a major milk-producing county in Minnesota.

Kansas City was selected as a likely demand point since it is a major consumption point in the market and in a location most likely to be served by this supply point. And while there are closer demand points available the volume of supply is large and would need to ship further and further south in order to get accommodated on a daily basis thus the selection of Kansas City as a demand point.

Making the same type calculations as before an every day shipment from Stearns County MN to a Kansas City demand point would **lose** \$151,380 or approximately \$0.72 cents per hundredweight.

The aforementioned producer association and diversion standards allow, a one-time delivery of 32,587 pounds able to qualify the entire volume and turn the losses into gains of \$282,222 / \$1.34 cwt. Again, these counties are in the marketing area of Federal Order 30 it is a little more difficult to avoid becoming associated with that Order and losing association with Order 32. But, Order 30 and 32 recognize the "split plant" provision making it somewhat easier to remain unassociated with Order 30 as a delivery to the nonpool side of a "split" manufacturing plant would not cause loss of association. As before, the pooling handler must have sufficient sales to qualify the diversion. A standard made easy by the Central Order provisions which allow the ability to "pyramid deliveries" in order to qualify larger volumes of milk.

Table 15 uses the same calculation method but applies the delivery standards of 20% and 25% that we propose and the gains are reduced from \$1.34 down to \$0.90 per hundredweight. Again this return must be compared with the return generated by the manufacturing plant, if the milk is to ship to the market every day and also with the Order 30 return. As in the case of the Wisconsin deliveries, marketing this milk to Kansas City every day would not likely generate enough dollars to attract and retain a milk supply.

As before this example does not consider the possibility that local in area milk could qualify the milk in this example and thus affect the return, but only considers how our proposal would work if this milk were to be forced to perform on its own.

Clearly however, if based on economic factors alone this milk would rarely if ever deliver to the market on a regular basis.

These examples demonstrate the economic incentives to exploit the lax pooling provisions of Order 32 and why the large volumes of milk detailed in the Market Administrator exhibits is being drawn to the Order. As explained in the Final Rule, there can be no rational explanation why this practice is a good idea for the market.

What is the effect on the Order 32 blend price of the milk from distant or "not historic locations"? Data computed in Exhibit _____ Tables 16 and 17 titled – **Impact on PPD of Distant Milk Pooled on the Central Order and Computations for Impact Analysis** provide some insight into the amount. Table 17 is a reasonable attempt to quantify the cost to the pool of the location adjustment value from the distant milk. Since the exact county location is not known for every month an estimate was made. For the case of Minnesota and Wisconsin a percentage factor was developed using September data. The pounds were taken from the Market Administrator exhibit. The location adjustment calculations were made with exact county comparisons if known or best estimates if not known. Extending the rates times the pounds yielded the dollar amount of the loss in pool value and the total of the pounds the volume of milk attributed with the dollars.

Table 16 uses this data to compute a pool loss. The total dollar value of the pool was taken from the monthly pool settlement statement. The total value was reduced by the component values. To the remaining dollars the location adjustment value computed from Table 17 was added back into the sum to get a "proxy value" as if those pounds had not been pooled. Dividing this proxy pool value by the actual pooled pounds and the

pounds that would have been in the pool if the "milk from non historic locations" was not pooled results in a "proxy value PPD" based on each volume. In each month the "proxy PPD" from the entire volume is very close to the actual PPD. Netting the two figures yields an approximate loss due to the distant milk becoming a part of the pool. The per hundredweight loss ranges from \$1.17/cwt to \$0.64/cwt for the four months selected to test. The total dollar value of the loss to the remaining producers ranged from \$3.7 million to \$9.5 million.

So why is this milk becoming associated with the market? The pooling requirements for Order 32, which work well for milk produced in the marketing area, do not work well when applied to milk produced out of the area. This coupled with the change in the pricing surface makes "open pooling" very lucrative. The Order 32 standards of touch base are easy to meet and even more so when coupled with the ability to "pyramid deliveries" for additional qualification.

Exhibit 9 Table 18 titled – **Example of Pyramid Qualification** demonstrates how the "pyramiding of qualification" works. In essence existing Order provisions in the most generous case allow for one load to qualify 15 additional loads. The handler on these loads must be both a 1032.9(c) handler and a pool plant operator at the same time.

As demonstrated in the MA exhibits by the steadily increasing pounds being pooled on the Order and further amplified in the English Exhibits 6 Table 2 titled – **Plants Included in the Central Federal Order Pool Computation January 2000 to Date With Reference to Qualifying Order Provision** there were 14 Cooperatives using this designation and 8 of the 14 were represented on the supply or plant operator listing.